

Date: January 25, 2013
To: Milton Dohoney, Jr., City Manager
From: Lauren Sundararajan, CFE, Internal Audit Manager *LS*
Copies to: Scott Stiles, Assistant City Manager
Richard Braun, Fire Chief
Kenneth Glenn, Director of Citizen Complaint and Internal Audit
Subject: **Fire Department Central Stores Audit**

Attached is the Fire Department Central Stores Audit report. This performance audit examined and evaluated the internal controls in place for the Central Stores operation. We have completed the report in accordance with Internal Audit's (IA) Fiscal Year 2012 Audit Work Plan.

We would like to thank the Cincinnati Fire Department's management and staff for their assistance and cooperation during this audit. All of their valuable time and efforts are greatly appreciated.

If you need any further information please contact me.

Attachment

Fire Department Central Stores Audit

January 2013



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Executive Summary

Internal Audit (IA) performed an audit of the City of Cincinnati Fire Department (CFD) Central Stores operation. The audit objectives were to ensure supplies and equipment are properly purchased, maintained, delivered, and disposed. While conducting the audit, IA found several internal control weaknesses that impair the effectiveness and efficiency of the operation. Some of the findings included in this report are the following: insufficient policies and procedures, inadequate segregation of duties, incomplete database information, and an inefficient operating environment.

Policies and procedures should be thorough and up to date. Central Stores' policies and procedures were last revised in 1996. Additionally, they lack policies and procedures regarding many critical processes, such as physical security, inventory database functions, supply requisitions, purchasing, inventory management, and individual job responsibilities.

Segregation of duties is a key concept of internal controls that helps prevent fraud and error. IA found that Central Stores lacks appropriate segregation of duties. Recordkeeping, inventory custody, and approval functions should be separated; however, many of these responsibilities overlap for Central Stores employees. The inventory database also fails to provide adequate segregation of duties, because it lacks customized access privileges for each employee based on their respective job responsibilities.

IA also determined that the Central Stores' inventory database is inadequate. Nonperformance of critical financial responsibilities, such as the annual physical inventory and recording purchases, contributed to incomplete inventory database information. The inventory database also contains inaccurate pricing data, vendor information, and shelf location descriptions. This has resulted in the inventory database becoming difficult to use. Furthermore, the inventory database does not provide sufficient data security. Each group of users shares the same username and password, eliminating the security capacity of audit trails.

An effective operating environment should be overseen by individuals who have knowledge and expertise to properly carry out the day to day business activities. Central Stores is overseen by a Fire Lieutenant, whose primary expertise is in fire operations. IA determined that Central Stores would operate most efficiently and effectively if supervised by a civilian who has knowledge in inventory controls and accounting processes. Additionally, administrative duties are split between the Administrative Services Bureau and the Executive Office, and reorganizing the reporting structure would help improve financial processes.

I. Introduction

Background

The CFD employs 817 sworn firefighters and 29 civilian employees. Central Stores is currently organized within the Administrative Services Bureau of the CFD. They are staffed with 1 Lieutenant, who supervises the Central Stores operation, and 5 civilian employees.

Central Stores is responsible for the purchase, storage, delivery, and repair of supplies for the CFD. They also serve as the liaison for other City services such as fleet management, equipment disposition, laundry service, and IT purchasing. As the central purchasing agent for the CFD, they oversee all supply orders for apparatus, equipment, station maintenance, and emergency medical service. The CFD annually budgets about \$8 million for non-personnel expenses; a majority of which flows through the Central Stores. At the end of 2011, Central Stores reported an inventory of over \$630,000.

Audit Selection

The audit was conducted as an agenda item on the 2012 internal audit workplan.

Audit Objectives

The audit objectives were to ensure supplies and equipment are properly purchased, maintained, delivered, and disposed.

Audit Scope and Methodology

The audit scope included all CFD personnel, records, systems, and facilities related to the stores' processes. The scope also included all items currently stored in the Central Stores storage areas and at firehouses. The audit primarily focused on transactions during 2012.

Audit methods included interviewing CFD staff, examining the CFD inventory tracking system, reviewing current CFD policies, interviewing City administration personnel, and benchmarking against practices of other cities.

Statement of Auditing Standards

As required by Article II, Section 15 of the City Administrative Code, this audit was conducted in accordance with the Generally Accepted Government Auditing Standards (GAGAS), except for standard 3.96 pertaining to external peer review requirements and standard 3.76 pertaining to staff CPE requirements. These exceptions did not have a material effect on the audit. Audit fieldwork was performed between July and October of 2012.

II. Audit Findings and Recommendations

Central Stores' policies and procedures are inadequate.

Policies and procedures provide an important management control for a stores operation. A well-designed policy and procedure manual is up to date and includes policies regarding the following: physical security, inventory database functions, supply requisitions, purchasing, inventory management, and individual job responsibilities. Central Stores' policies and procedures were last revised in 1996. Additionally, they lack policies regarding many critical processes. Failure to implement up to date and thorough policies and procedures could impair management's ability to provide proper oversight.

Recommendation 1:

Central Stores should update their policies and procedures to reflect current operating practices.

Recommendation 2:

The CFD should notify all CFD employees about the updated Central Stores' policies and procedures.

Central Stores does not prohibit the entrance of outsiders into the storage area.

Due to the high value of supplies stored at Central Stores, it is best practice to minimize unnecessary traffic in and out of the storage area. CFD personnel stated that access is granted to firefighters, but supervision is required. Accordingly, there is a sign posted in Central Stores that reflects this practice. While this rule is in place to reduce the threat of pilferage of supplies, security can be enhanced even further by completely disallowing unauthorized individuals to enter the storage area.

Recommendation 3:

Central Stores should document and implement a procedure that allows only Central Stores employees and individuals specifically authorized by the CFD to enter the storage area. Appropriate signage should reflect this procedure.

Fire company commanders do not approve all requisitions.

In order to obtain needed supplies, fire companies use the requisition function of the inventory database via the City's intranet. CFD Central Stores procedure 1201.05(E) states that "requisitions for supplies are to be made by the company commander." Through interviews with CFD personnel, IA found that this does not consistently occur, and often it is firefighters who submit supply requisitions. Furthermore, the requisition function allows any CFD employee to submit supply requisitions, and does not limit this responsibility to company commanders. Central Stores accepts supply requisitions from all department employees and does not enforce the CFD procedure. Holding the commanders responsible and limiting the number of personnel allowed to submit requisitions reduces the exposure for abuse or unnecessary purchases through segregation of duties.

In addition to the monthly ordering process done via the intranet, Central Stores is open for a few hours each weekday morning to allow firefighters and staff to walk in and make supply requisitions. CFD personnel stated that these requisitions require a firefighter's employee ID

number and signature, but do not require supervisor permission or approval. Although a paper trail is initiated, these records do not reach the firehouses. Without commander supervision or approval, there is a risk that firefighters can obtain supplies, on or off duty, and take them for personal use.

Recommendation 4:

The CFD should enforce procedure 1201.05(E) requiring company commanders to submit supply requisitions. This should encompass all intranet supply requisitions, all irregular and special requisitions, and walk-in requisitions.

Recommendation 5:

The CFD should restrict the access of the inventory database users to conform to procedure 1201.05(E).

Inventories throughout the Fire Department are not reviewed for appropriateness.

Inventories throughout the CFD should be kept at reasonable levels. IA observed that some of the firehouses stored excessive, obsolete, and unneeded supplies. Firehouse #3 had a large supply of laundry detergent that was accidentally ordered. They also had unusable medical equipment that was made obsolete by a newer product. Firehouse #31 had numerous unwanted supplies stored in their basement. IA also found obsolete supplies kept at the Central Stores storage facility. Hoarding unusable supplies reduces storage space, increases purchasing expenses, and makes budgets more difficult to manage.

Recommendation 6:

The CFD should document and implement a policy outlining a process for remitting excessive, obsolete, and unneeded firehouse supplies back to Central Stores.

Recommendation 7:

Central Stores should document and implement a process for annually reviewing its inventory for usefulness and eliminating unwanted supplies. Attempts should be made to sell supplies back to the vendor, sell as scrap, recycle, or share with other local municipalities as an alternative to throwing them away.

Central Stores lacks segregation of duties.

In order to maintain proper segregation of duties; recordkeeping, inventory custody, and approval functions must be separated from another. IA found that the Storekeepers approve supply requisitions, enter records into the database, submit purchase orders to the vendors, and maintain inventory. An ideal setup would have the Storekeepers and their staff as custodians of the inventory that receive, stock, and distribute inventory; the supervisor would be in charge of approving purchases and requisitions, reconciling inventory adjustments, certifying funds and invoice payments, and updating vendors in the database; and the Accounting Technician II would function as the record keeper and be responsible for ordering supplies and recording purchases and issuances in the database. Proper segregation of duties reduces the risk of loss.

Recommendation 8:

The Central Stores should ensure segregation of duties by delegating the following duties: the Central Stores supervisor should be responsible for approving purchases and requisitions, the

Accounting Technician II should be responsible for recordkeeping, and the Storekeepers should be responsible for custody of inventory.

Accounting duties were not performed.

In order for the inventory database to be useful, transactions must be recorded as they occur. CFD personnel stated that the Accounting Technician II position has been vacant since March 2012. Most accounting responsibilities, such as entering purchases into the inventory database, have not been performed during the vacancy. Continued nonperformance of critical responsibilities could result in the inventory database becoming increasingly difficult to utilize.

Recommendation 9:

Central Stores should continuously perform duties that are critical to the integrity of the database, even in times of employee turnover.

Recommendation 10:

Central Stores should enter in historical purchase data that was omitted from the database.

Physical inventory counts were not performed.

Annual physical inventory counts are a necessary process of an inventory operation. CFD personnel stated that they are to perform a physical inventory annually. IA found that Central Stores did not perform the annual physical inventory during 2012, and the last one was performed in February 2011. Annual physical inventory counts are designed to uncover errors and irregularities in the inventory database. Failure to perform this responsibility puts the organization at a heightened risk of loss.

CFD personnel stated that the variances between the inventory database and physical inventory are to be investigated and recorded in the inventory database during the weeks when the Central Stores is closed for the inventory. For the last physical inventory, performed in February 2011, no records were found that indicate variances were ever investigated. Additionally, IA found that inventory adjustments were not recorded until April 2011, and many of the quantity variances went unrecorded.

The Central Stores is required to annually submit an inventory list to the Finance Department for inclusion in the Comprehensive Annual Financial Report (CAFR). The Finance Department relies on them to provide accurate data. IA found that the 2011 inventory list was inaccurate, because a physical inventory was not performed and recent physical inventory count data was not recorded. Continued misreporting of City assets could pose serious financial consequences.

Recommendation 11:

Central Stores should annually perform a physical inventory. The United States General Accounting Office's *Executive Guide: Best Practices in Achieving Consistent, Accurate, Physical Counts of Inventory and Related Property* should be used as an informational resource for performing physical inventories.

Recommendation 12:

Central Stores should immediately document and investigate physical inventory variances, and CFD management should record and approve inventory adjustments in a timely manner.

Recommendation 13:

Central Stores should report accurate physical inventory information to the Finance Department.

Supply catalog information is not up to date.

The supply catalog function of the inventory database lists all inventory items available for requisition. All items are permanently maintained in the catalog. Fire companies have the ability to request any item, even if obsolete. Requisitions for obsolete items are not filled, because Central Stores personnel sort out obsolete items each time they are requested. Therefore, reducing the number of items listed in the catalog will make the requisition approval process more efficient.

The supply catalog contains information regarding the shelf location, vendor, and price for each item. IA found several examples in which price information was incorrect. For example, IA found items with negative price amounts, items that do not have a price listed, and comparable items with prices that vary considerably. Price information is vital for accurate financial reporting. In addition, IA's testing found 3 shelf locations in the sample of 42 that were incorrect. Accurate shelf locations provide information for efficiently stocking and retrieving items.

Recommendation 14:

Central Stores should remove obsolete inventory items from the supply catalog.

Recommendation 15:

Central Stores should review the accuracy of shelf locations, vendor names, and prices stored in the inventory database. In addition, information should be updated any time it changes.

Low inventory reports are not used.

Low inventory reports efficiently show which supplies need to be ordered in the near future. IA found that Central Stores does not run this report. Rather, in order to determine low shelf quantities, Central Stores personnel physically check the inventory in the storage area. This process is not only inefficient, but is also susceptible to human error. A low inventory report assists Central Stores personnel in making appropriate purchasing decisions.

Recommendation 16:

Once the database has been updated, Central Stores should document and implement a process to regularly utilize a low inventory report.

Exception reports are not used.

Exception reports are computer generated reports that can show adjustments made to quantity levels in the inventory database. IA found that the CFD does not run exception reports. Exception reports are essential for evaluating adjustments for appropriateness and discovering concealment of theft.

Recommendation 17:

CFD management should regularly receive an exception report showing all quantity adjustments made to the database.

The inventory database lacks security controls.

The most effective and efficient method of securing logical access to a database is through the use of unique usernames and passwords. IA found that currently all Central Stores employees' access privileges to the inventory database are controlled by a shared username and password. Therefore, all Central Stores employees have the same access privileges, even though they do not require the same privileges to perform their job duties.

The only Central Stores employee with a unique username and access privilege for the inventory database is the supervisor with override privileges. Override privileges are assigned to the Central Stores supervisor in order to record differences between physical inventories and inventory database records. The City's Information Security Policy states that "managers are required to implement a process to perform period reviews of their employee's access privileges and to recertify employees that transfer in/out of their respective departments." IA found that two former Central Stores employees are still assigned access and override privileges to the inventory database. In addition, the current supervisor does not have the necessary override privileges.

An audit trail allows management to independently review transactions made by employees. IA found that the inventory database does not have the capability of tracking who made what transaction. This capability would improve the security of the inventory database and allow for management review.

Recommendation 18:

Central Stores should work with IT to assign unique usernames and the following access privileges to Central Stores employees to parallel the job duties suggested in recommendation 8: eliminate inventory database access for storekeepers and their subordinates, allow the Accounting Technician II to have inventory database privileges for recording inventory transactions, and grant the supervisor override access for making inventory adjustments.

Recommendation 19:

CFD management should annually review database access rights to verify need. This should also be performed when an employee transfers in or out of Central Stores.

Recommendation 20:

Central Stores should consider improving the current database or purchasing a new one in order to track critical security measures, such as audit trails.

Central Stores does not operate efficiently and effectively.

An efficient and effective Central Stores operation must be supervised by individuals who have knowledge and expertise in all Central Stores operations. Currently a sworn Lieutenant supervises the Central Stores. Lieutenants have expertise in fire operations, but typically lack a financial background. In addition, CFD management stated that the Lieutenant is required to receive training for several weeks each year that relates to fire operations, and does not apply to stores operations. Furthermore, the Lieutenant's collectively bargained work schedule is a 10-hour shift for four days each week. This is problematic for supervising Central Stores, which operates five days each week. Moving to a civilian-run Central Stores operation would improve accountability, functionality, and efficiency.

A well-organized business structure leads to an efficient and effective stores operation. IA found that the Executive Office manages budgets, expenditures, contract services, and other administrative functions for the CFD. The Administrative Services Bureau is responsible for computer systems, equipment, and the Central Stores operation. Central Stores' inability to control its budget and expenditures creates an inefficient operation. Disregarding the ineffective reporting environment could lead to supply shortages and increased expenditures. A reorganized administrative function would improve accountability, functionality, and efficiency.

Recommendation 21:

The CFD should replace the Central Stores supervisor with a civilian and reassign the Lieutenant to fire operations.

Recommendation 22:

The CFD should consider reorganizing the Central Stores, Executive Office, and Administrative Services Bureau to improve financial processes.

III. Conclusion

IA concludes that Central Stores has several major internal control issues that prevent them from accomplishing their goals and objectives. Some of the major issues contribute to the Central Stores' ineffectiveness include inadequate policies and procedures, inadequate segregation of duties, a lack of complete data and critical controls in the inventory database, and an inefficient operating environment. These deficiencies significantly increase the risk of loss. Due to the immense volume of resources controlled by Central Stores, even small internal control weaknesses cannot be ignored.

Many steps are needed to bring the Central Stores operation to an optimal level. Above all, IA concludes that Central Stores would operate most efficiently and effectively if supervised by a civilian who has knowledge in inventory controls and accounting processes. Additionally, a reorganized reporting structure between the Central Stores, Executive Office, and Administrative Services Bureau would help improve internal controls, budgeting processes, financial reporting, and storeroom efficiencies.

IV. Fire Department Response

Recommendation 1:

Central Stores should update their policies and procedures to reflect current operating practices.

Department Response:

CFD agrees.

Recommendation 2:

The CFD should notify all CFD employees about the updated Central Stores' policies and procedures.

Department Response:

CFD agrees.

Recommendation 3:

Central Stores should document and implement a procedure that allows only Central Stores employees and individuals specifically authorized by the CFD to enter the storage area. Appropriate signage should reflect this procedure.

Department Response:

CFD agrees.

Recommendation 4:

The CFD should enforce procedure 1201.05(E) requiring company commanders to submit supply requisitions. This should encompass all intranet supply requisitions, all irregular and special requisitions, and walk-in requisitions.

Department Response:

CFD agrees except when ordering supplies by another company officer becomes necessary due to the extended leave of the company commander, and whereby the immediate ordering supplies is essential to a respective fire company's mission. This will be reflected in the new procedure.

Recommendation 5:

The CFD should restrict the access of the inventory database users to conform to procedure 1201.05(E).

Department Response:

CFD agrees.

Recommendation 6:

The CFD should document and implement a policy outlining a process for remitting excessive, obsolete, and unneeded firehouse supplies back to Central Stores.

Department Response:

CFD agrees.

Recommendation 7:

Central Stores should document and implement a process for annually reviewing its inventory for usefulness and eliminating unwanted supplies. Attempts should be made to sell supplies back to the vendor, sell as scrap, recycle, or share with other local municipalities as an alternative to throwing them away.

Department Response:

CFD agrees.

Recommendation 8:

The Central Stores should ensure segregation of duties by delegating the following duties: the Central Stores supervisor should be responsible for approving purchases and requisitions, the Accounting Technician II should be responsible for recordkeeping, and the Storekeepers should be responsible for custody of inventory.

Department Response:

CFD agrees including that all of the above is performed with oversight by the Division District Chief and the Division Assistant Chief.

Recommendation 9:

Central Stores should continuously perform duties that are critical to the integrity of the database, even in times of employee turnover.

Department Response:

CFD agrees except when this is beyond the ability of assigned CFD personnel.

Recommendation 10:

Central Stores should enter in historical purchase data that was omitted from the database.

Department Response:

With the hiring of the new Accounting Technician 2, CFD has begun and will continue to do this to every extent possible.

Recommendation 11:

Central Stores should annually perform a physical inventory. The United States General Accounting Office's *Executive Guide: Best Practices in Achieving Consistent, Accurate, Physical Counts of Inventory and Related Property* should be used as an informational resource for performing physical inventories.

Department Response:

CFD agrees and requests assistance from City experts (Finance) who are proficient with this document.

Recommendation 12:

Central Stores should immediately document and investigate physical inventory variances, and CFD management should record and approve inventory adjustments in a timely manner.

Department Response:

CFD agrees.

Recommendation 13:

Central Stores should report accurate physical inventory information to the Finance Department.

Department Response:

CFD agrees.

Recommendation 14:

Central Stores should remove obsolete inventory items from the supply catalog.

Department Response:

CFD agrees.

Recommendation 15:

Central Stores should review the accuracy of shelf locations, vendor names, and prices stored in the inventory database. In addition, information should be updated any time it changes.

Department Response:

CFD agrees and has already begun to catch up in 2013.

Recommendation 16:

Once the database has been updated, Central Stores should document and implement a process to regularly utilize a low inventory report.

Department Response:

CFD agrees. This will be included in an updated procedure.

Recommendation 17:

CFD management should regularly receive an exception report showing all quantity adjustments made to the database.

Department Response:

CFD agrees.

Recommendation 18:

Central Stores should work with IT to assign unique usernames and the following access privileges to Central Stores employees to parallel the job duties suggested in recommendation 8: eliminate inventory database access for storekeepers and their subordinates, allow the

Accounting Technician II to have inventory database privileges for recording inventory transactions, and grant the supervisor override access for making inventory adjustments.

Department Response:

CFD agrees. Storekeepers and subordinates will have read-only privileges (no edit capabilities).

Recommendation 19:

CFD management should annually review database access rights to verify need. This should also be performed when an employee transfers in or out of Central Stores.

Department Response:

CFD agrees.

Recommendation 20:

Central Stores should consider improving the current database or purchasing a new one in order to track critical security measures, such as audit trails.

Department Response:

CFD agrees and this is in progress.

Recommendation 21:

The CFD should replace the Central Stores supervisor with a civilian and reassign the Lieutenant to fire operations.

Department Response:

CFD agrees. Upon approval by the City Vacancy Review Board/City Manager, CFD will begin the process to hire a civilian to take over as the supervisor of Central Stores. After a civilian is hired, CFD (Admin) will reassign the (former Central Stores) Fire Lieutenant to the Emergency Communications Center Liaison Position replacing the Fire Captain. CFD (Admin) will then reassign the (former ECC-Liaison) Fire Captain to Fire Training.

Recommendation 22:

The CFD should consider reorganizing the Central Stores, Executive Office, and Administrative Services Bureau to improve financial processes.

Department Response:

CFD will consider reorganization of the above-mentioned areas of operations in order to improve financial processes.